United Nations E/2016/63

Economic and Social Council

Distr.: General
5 May 2016

Original: English

2016 session
24 July 2015-27 July 2016
Agenda item 5
High-level segment

World economic situation and prospects as of mid-2016*

Summary

Weak global growth continues to linger, posing a challenge to the implementation of the 2030 Agenda for Sustainable Development. The world gross product is projected to expand by just 2.4 per cent in 2016, the same weak rate as in 2015. This reflects significant downward revisions of growth for many countries in Africa, the Commonwealth of Independent States, and Latin America and the Caribbean compared with the forecasts in December 2015. Persistent weakness in aggregate demand in developed economies remains a drag on global growth, while low commodity prices, mounting fiscal and current account imbalances and policy tightening have further dampened the growth prospects of many commodity-exporting economies. The already bleak growth prospects have been compounded by severe weather-related shocks, political challenges and large capital outflows in many developing regions.

Downside risks to the global economy remain elevated against the backdrop of weak demand, low investment, low commodity prices and the financial market turbulence. Divergent global inflationary pressures have prompted procyclical monetary tightening in several developing economies, in contrast to additional monetary easing in the euro area and Japan, and delays in interest rate rises by the United States Federal Reserve. Increased divergence in global interest rates may intensify capital flow volatility and exchange rate pressures in developing economies. Greater policy coordination among countries could mitigate the negative spillover effects of policy misalignment and contain financial market volatility. There is also a growing need to reduce high dependency on monetary policy by exploiting available fiscal space and other policy measures to boost global growth.

* The present document updates *World Economic Situation and Prospects 2016* (United Nations publication, Sales No. E.16.II.C.2), released in January 2016.

16-06584 (E) 180516

Please recycle

I. Global macroeconomic trends

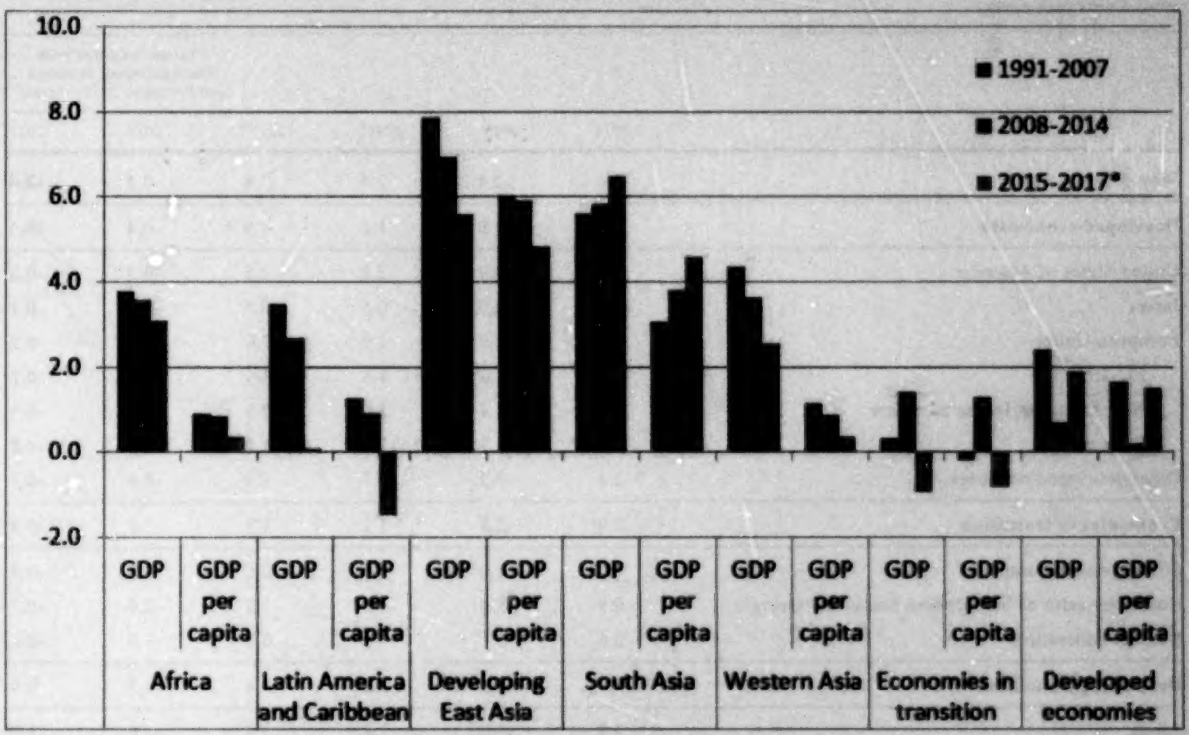
Global growth prospects

1. Economic activity in the world economy remains lacklustre, with little prospect for a turnaround in 2016. The prolonged period of slow global growth poses a challenge to the implementation of the 2030 Agenda for Sustainable Development, given that financing constraints continue to remain formidable. After a tumultuous start to 2016, global financial markets have largely stabilized, given that equity prices, the prices of primary commodities, and the currencies of emerging economies have recovered the losses suffered at the beginning of the year. Nevertheless, the world economy continues to face major headwinds identified in *World Economic Situation and Prospects 2016*, which are unlikely to ease in the near term. The world gross product is expected to expand by just 2.4 per cent in 2016, the same rate as in 2015. This marks a significant downward revision of 0.5 percentage points to forecasts reported in December 2015. Global economic growth prospects for 2017 also remain well below pre-crisis trends, and a protracted period of slow productivity growth and feeble investment weigh on the longer-term potential of the global economy.

2. The revised forecast reflects significant downward adjustments in the growth rates of many countries in Africa, the Commonwealth of Independent States (CIS), and Latin America and the Caribbean, where tighter policy stances have exacerbated the effects of a series of adverse shocks. Further falls in commodity prices since October 2015 have pushed fiscal and current account balances deep into deficit and put downward pressure on exchange rates in the many commodity-exporting countries in those regions, while severe drought related to El Niño effects has led to a sharp drop in agricultural output and localized spikes in food prices in parts of Africa, Asia, and Latin America and the Caribbean,[1] pushing up inflation and leading to monetary tightening in several economies. At the same time, internal political difficulties and other country-specific domestic factors have compounded the pressures from large capital outflows and rising debt levels. In particular, the recessions in Brazil and the Russian Federation have proved longer and deeper than anticipated, with significant regional spillovers. As a whole, economic growth in the developing countries in 2016 is unlikely to exceed the 3.8 per cent growth recorded in 2015. When viewed in per capita terms, the slowdown in gross domestic product (GDP) growth in many developing regions is particularly stark (figure I).

[1] See World Economic Situation and Prospects Monthly Briefing No. 89 (April 2016) for an analysis of the economic impact of El Niño.

Figure I
Gross domestic product and gross domestic product per capita growth



Source: Department of Economic and Social Affairs.
* Includes estimates and forecasts.

3. While inflationary pressures have prompted monetary tightening measures in many developing economies, the further decline in commodity prices has prompted additional monetary easing measures in the euro area and Japan, which are both pursuing negative interest rate policies.[2] The United States Federal Reserve is now expected to postpone further interest rate rises until the latter part of 2016. As the divergences between rates of return at the global level increase, there is a risk that capital flow and exchange rate volatilities could intensify again, heightening financial risks and further dampening global economic prospects. Greater coordination among the major central banks in the developed countries would mitigate the adverse spillovers to the developing countries, which face difficult policy choices as they seek to strike a balance between their objectives of stimulating economic growth and maintaining moderate inflation, stable currencies and financial stability.

[2] See World Economic Situation and Prospects Monthly Briefing No. 88 (March 2016) for a discussion of the potential risks associated with negative interest rate policies.

Table 1
Growth in world output, 2014-2017
(Annual percentage change)

	2014	2015[a]	2016[b]	2017[b]	Change compared with World Economic Situation and Prospects 2016 forecast	
					2016	2017
World	2.6	2.4	2.4	2.8	-0.5	-0.4
Developed economies	1.7	1.9	1.8	1.9	-0.4	-0.4
United States of America	2.4	2.4	2.2	2.5	-0.4	-0.3
Japan	-0.1	0.5	0.5	0.5	-0.8	-0.1
European Union	1.4	1.9	1.9	2.0	-0.1	-0.2
EU-15	1.2	1.8	1.8	1.9	-0.2	-0.2
New European Union members	2.7	3.4	3.0	2.9	0.0	-0.3
Euro area	0.9	1.7	1.7	1.8	-0.2	-0.2
Other developed countries	2.4	1.7	1.7	1.9	-0.4	-0.7
Economies in transition	0.9	-2.8	-1.2	1.1	-2.0	-0.8
South-Eastern Europe	0.2	2.0	2.3	2.6	-0.3	-0.4
Commonwealth of Independent States and Georgia	0.9	-3.0	-1.3	1.1	-2.0	-0.7
Russian Federation	0.6	-3.7	-1.9	0.6	-1.9	-0.6
Developing economies	4.4	3.8	3.8	4.4	-0.5	-0.4
Africa	3.8	3.0	2.8	3.4	-1.6	-1.0
North Africa	1.8	3.0	2.4	3.2	-1.7	-0.9
East Africa	6.5	5.7	6.1	6.2	-0.7	-0.4
Central Africa	5.8	3.0	4.1	4.6	-0.2	0.4
West Africa	6.1	3.3	3.4	3.9	-1.8	-1.4
Southern Africa	2.7	1.9	1.3	2.1	-1.7	-1.2
East and South Asia	6.1	5.7	5.7	5.8	-0.1	0.0
East Asia	6.1	5.7	5.5	5.6	-0.1	0.0
China	7.3	6.9	6.4	6.5	0.0	0.0
South Asia	6.3	6.1	6.6	6.8	-0.1	-0.2
India	7.2	7.3	7.3	7.5	0.0	0.0
Western Asia	2.8	2.8	2.4	2.7	0.0	-0.3
Latin America and the Caribbean	1.0	-0.6	-0.6	1.5	-1.3	-1.2
South America	0.5	-1.9	-1.9	0.9	-1.8	-1.5
Brazil	0.1	-3.8	-3.4	0.2	-2.6	-2.1
Mexico and Central America	2.5	2.8	2.7	2.9	-0.2	-0.5
Caribbean	3.4	4.0	3.4	3.9	-0.2	0.6
Least developed countries	5.6	3.9	4.8	5.5	-0.8	-0.1

	2014	2015[a]	2016[b]	2017[b]	Change compared with World Economic Situation and Prospects 2016 forecast: 2016	2017
Memorandum items:						
World trade[c]	3.4	2.4	3.1	4.1	-0.9	-0.6
World output growth with purchasing power parity-based weights	3.3	3.0	3.1	3.6	-0.5	-0.3

Source: Department of Economic and Social Affairs.

[a] Partly estimated.

[b] Forecast, based in part on Project LINK.

[c] Includes goods and services.

Capital inflows and exchange rates

4. Large developing economies remain prone to capital flow volatility and exchange rate pressures. Notwithstanding some revival in the first months of 2016, the depressed level of capital flows relative to 2011 is projected to continue, albeit to a lesser extent compared with the sharp capital reversal last year. In 2015, as the growth gap with the developed countries narrowed, net capital outflows from emerging economies reached $570 billion, with gross inflows plummeting to $290 billion — after averaging $1.2 trillion between 2010 and 2014 — and gross outflows posting $860 billion.[3] Capital outflows from China surged, reflecting corporate efforts to reduce their exposure to dollar-denominated debt and expectations of a depreciation of the renminbi. Although foreign direct investment (FDI) flows remained strong overall, they declined in Africa, Latin America and the economies in transition.[4]

5. Against the backdrop of increasing "flight to safety" activity, government bond yields declined further in the developed countries and gold prices posted their highest quarterly increase in more than two decades, while global equity markets and oil prices plummeted amid heightened currency volatility. Financial and commodity markets have largely stabilized and recovered from the losses suffered at the start of 2016, and capital flows to developing countries, notably Brazil, India, the Philippines and Taiwan Province of China, have also seen some revival. This incipient increase in capital inflows will be difficult to sustain, given that the growth outlook in emerging economies remains bleak, with limited scope for policy support in many countries, while excess capacity and low commodity prices continue to weigh on investment demand. Without greater coordination among the major central banks in the developed countries, a widening divergence in global interest rates in 2017 may have disproportionately large effects on portfolio flows to the developing countries, with renewed pressures on exchange rates.

6. The sharp decline in net capital flows since 2011 poses significant challenges to emerging economies as they struggle to reinvigorate growth and investment demand in a context of subdued commodity prices. Capital outflows tend to put

[3] Institute of International Finance, *Capital Flows to Emerging Markets* (January 2016).

[4] United Nations Conference on Trade and Development, *Global Investment Trends Monitor*, No. 22 (Geneva, 20 January 2016).

downward pressure on exchange rates and depress equity prices, increasing debt-to-equity ratios and deleveraging pressures and the likelihood of defaults. Currency pressures restrict monetary policy space, and several emerging economies, including Colombia, Egypt, Mexico, Nigeria and South Africa, have been compelled to increase interest rates in recent months, despite deteriorating economic prospects. The simultaneous decline in capital flows and commodity prices requires significant macroeconomic and structural adjustments, which might in turn lead to financial distress, surges in external financing costs and corporate or sovereign defaults and increase the risk of a debt crisis. Export-oriented and commodity-dependent economies are particularly vulnerable, especially those with relatively large current account deficits and high dollar-denominated debt.

7. High levels of international reserves and greater exchange rate flexibility in several economies have so far provided a significant cushion to gradually cope with the capital flow reversal. In the near term, the scope for countercyclical monetary policy loosening in many emerging economies may remain limited. Developing countries may need to use macroprudential regulations and, in some cases, targeted and selective capital controls to stabilize excessive capital flows and exchange rate volatility. Fundamentally, improving growth prospects against many odds remains a key strategy for many developing countries to restore a more virtuous cycle among capital flows, investment and development.

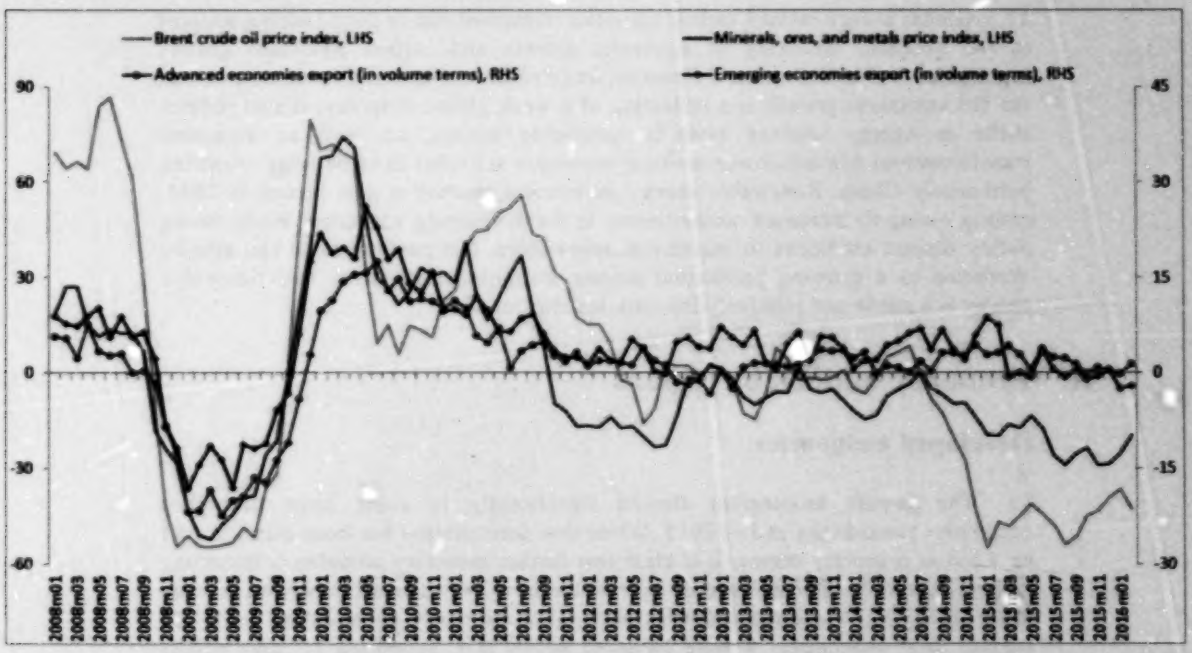
Trade flows and commodity prices

8. Global trade growth is projected to remain tepid in 2016, recovering slightly from the estimated 2.4 per cent growth in 2015 to 3.1 per cent in 2016. This lukewarm outlook is supported by the latest merchandise trade data from the last quarter of 2015 and the first months of 2016, although services trade has proved more resilient. Developed economies, particularly Western Europe, should continue to drive global trade during the forecast period. Trade growth in developing East Asia, a long-time engine of global trade, is set to experience very modest improvement in 2016, while CIS is expected to be the only region to experience an export decline in real terms in 2016, underpinned by weak economic prospects and geopolitical tensions. The mega-regional trade agreement, Trans-Pacific Partnership, was signed in February 2016 by 12 nations, which account for 40 per cent of world gross product. However, given its two-year ratification period, which will face political hurdles in a number of countries, the trade deal is unlikely to have a material impact on global trade in the near term.

9. Preliminary statistics show that global commercial services trade declined in value terms in 2015 for the first time since 2009, largely driven by the depreciation in major currencies against the United States dollar. The sharp drop in the value of merchandise trade also partly reflects the strength of the United States dollar, as well as the low level of commodity prices. Notwithstanding some recovery from the lows reached in January, oil prices were 17 per cent lower in March 2016 compared with the September 2015 levels. Natural gas prices also fell by over 30 per cent during the same time period. Oil prices are expected to remain at low levels in 2016, although the price forecast remains subject to a significant margin of uncertainty, as discussed further in section III below.

10. Amid continued oversupply in most markets, certain industrial metals, including copper and iron, also saw lower prices at the turn of the year, but prices either stabilized or rebounded in the first quarter of 2016. The rebound coincided with a slight pickup in China's demand for metals, including copper, iron and steel, reflecting the modest uptick in housing construction and the expansion of certain copper-intensive industries, such as the auto industry and renewable energy. Metal prices, however, are unlikely to receive significant demand support from China during the forecast period, as the economy moves to address industrial overcapacity and excessive housing inventory.[5] Despite strong El Niño effects on consumer prices for food in several countries, global agricultural prices have continued on a multi-year decline, as stock levels remain high.

Figure II
Exports and commodity prices, year-on-year growth



Source: CPB Netherlands Bureau for Economics; UNCTADStat.
Abbreviations: LHS, left-hand scale; RHS, right-hand scale.

Labour markets

11. Recent indicators for the United States of America and Europe suggest more robust labour market developments in developed economies. However, the persistently weak global economy has taken a toll on employment in many developing and transition economies, particularly those that have suffered a significant loss of commodity-related revenue, such as Brazil and Nigeria.

[5] See discussion in World Economic Situation and Prospects Monthly Bulletin No. 87 (February 2016).

Worldwide, it is estimated that 27 million more people are unemployed today than on the eve of the financial crisis, and that figure is expected to rise further in the coming two years. Even in countries with relatively low unemployment, youth unemployment rates are particularly high, which has important social ramifications. Poor job quality also remains a pressing issue. In South Asia and sub-Saharan Africa, more than two thirds of workers face vulnerable employment conditions, with little or no access to social protection schemes, high levels of job insecurity, and low and volatile earnings. Widespread global unemployment and job insecurity pose a significant challenge to global efforts to promote inclusive and sustainable economic growth, employment and decent work for all, as envisaged in the 2030 Agenda for Sustainable Development.

Carbon emissions and gross domestic product growth

12. Global energy-related carbon emissions remained flat in 2015, adding support to the potential delinking of economic growth and carbon emissions growth highlighted in *World Economic Situation and Prospects 2016*. While to some extent, the flat emissions growth is a reflection of a weak global economy, it also reflects shifts in energy sources towards renewable energy, as well as structural transformations towards lower-emitting economic activities in some large countries, particularly China. Renewable energy investment reached a new record in 2015, mainly owing to increased commitments in the developing countries. While strong policy support continues to incentivize renewables, this positive trend can also be attributed to a growing realization among institutional investors that renewable energy is a stable and relatively low-risk investment.

II. Economic outlook by regions

Developed economies

13. The growth momentum slowed significantly in some large developed economies towards the end of 2015. While that deterioration has been offset in part by a looser monetary stance, it is clear that further monetary stimulus is becoming increasingly ineffective and can be expected to have only a small impact on growth. Since 2010, the developed countries have relied primarily on monetary policy to support their economies. A more balanced policy mix, supported by more robust fiscal policy stances and coordinated among the largest economies, could provide a much-needed impetus to the global economy.

14. In the United States, GDP growth is expected to reach just 2.2 per cent in 2016. The revival of business investment in the United States lost momentum in 2015, culminating in a sharp drop in the final quarter. Labour market indicators are generally favourable, but manufacturing and mining industries are showing signs of strain, reflecting the low price of oil and the strong dollar, which appreciated by 13 per cent in nominal effective terms in 2015. Notwithstanding some uptick in inflation, core inflation remains below 2 per cent, and the Federal Reserve is expected to remain cautious regarding further interest rate rises.

15. GDP growth in Japan has exhibited significant volatility in recent quarters and the economy remains plagued by weak household consumption. Notwithstanding

further monetary easing in January 2016, the recent appreciation of the yen will also continue to weigh on the economy in 2016-2017, and GDP growth is forecast to average 0.5 per cent in both years. This assumes that the proposed consumption tax increase scheduled for April 2017 will be postponed. If, however, the tax increase is implemented, Japan could fall back into recession in 2017.

16. The economy of the European Union is expected to expand by 1.9 per cent in 2016 and 2.0 per cent in 2017, representing only a slight downward revision compared with *World Economic Situation and Prospects 2016*. While private consumption in a number of economies is supported by improving labour market conditions, business investment is restrained by heightened global economic uncertainty. The capital goods manufacturing sector, in particular, is hampered by weaker demand from China and depressed conditions for global energy exploration and investment. While fiscal expansion could give a much-needed boost to growth, high debt levels and political constraints continue to prevent a more supportive role for fiscal policy in Europe.

Economies in transition

17. The near-term economic forecast for the CIS region has been revised downwards against the background of lower international energy prices, a less favourable global environment, the contractionary impact of tighter fiscal policies and domestic political uncertainties. Among the major energy exporters, Azerbaijan, Kazakhstan and the Russian Federation are expected to register GDP declines in 2016. Notwithstanding some improvement in the monthly dynamics, GDP in the Russian Federation is forecast to contract by 1.9 per cent in 2016 owing to fiscal tightening and further declines in private consumption and investment, while international sanctions continue. Among the energy importers, the economy of Ukraine is expected to stagnate in 2016. Suspension of the free trade agreement with Ukraine by the Russian Federation and the imposition of a food embargo may have tangible impacts on the Ukrainian economy, despite already weaker bilateral trade. Generally low growth rates are projected for the smaller CIS economies in 2016 against the backdrop of a significant contraction in remittances from the Russian Federation and sharp currency depreciations in 2015. The aggregate GDP of CIS and Georgia, which shrank by 3.0 per cent in 2015, is expected to contract further, by 1.3 per cent, in 2016 and return to modest growth of 1.1 per cent in 2017. Inflation is expected to moderate as currencies stabilize, but will remain at double-digit rates in some cases. Meanwhile, unemployment is expected to increase, owing in particular to diminished opportunities for the migrant workers from the Caucasus and Central Asia.

18. Notwithstanding some easing of monetary policies in early 2016 in response to reduced exchange rate volatility and slowing inflation, near-term investment prospects in the region remain bleak, aggravated by weaknesses in the banking sector in particular. This follows several years of weak investment (especially in the Russian Federation and Ukraine), which threatens future potential output and growth. To revitalize economic growth, several Governments are considering ambitious privatization programmes, which would help to finance fiscal deficits but might adversely affect employment. Fiscal buffers such as sovereign wealth funds are also being drawn down to meet current fiscal obligations. While a number of CIS countries have designed anti-crisis fiscal measures to support certain industries

and to mitigate the social consequences of recession, the overarching fiscal stance in the region remains tight.

19. Diversification of the CIS economies — and for the smaller ones, diversification of their export markets as well — remains a key medium-term challenge. A sustained period of low oil prices remains a major risk for the region, along with the fragilities in the banking system and geopolitical challenges.

20. Prospects for South-Eastern Europe, on the other hand, remain more favourable, supported by stronger demand from the European Union and low energy prices. Regional GDP increased by 2.0 per cent in 2015, with projected acceleration to 2.3 per cent growth for 2016 and 2.6 per cent for 2017. Lower fuel and food prices kept inflation in South-Eastern Europe near zero in 2015 and, despite the stronger economic activity, inflation should remain at low levels in 2016. Labour market trends in general have improved, although unemployment in Serbia may increase because of fiscal retrenchment linked to the International Monetary Fund programme.

21. The Governments in South-Eastern Europe are facing the dilemma of pursuing fiscal consolidation and, in some cases, addressing current account deficits, while stimulating economic expansion. Medium-term prospects are also constrained by infrastructure and energy bottlenecks, low labour force participation, nascent financial markets and a business environment that is often challenging. The migrant crisis in Europe compounds the challenges for the region.

Developing countries

Asia

22. The developing economies of East Asia are expected to see only a modest deceleration in growth in 2016, with the slowdown in China offset in part by acceleration in the rest of the region. Domestic demand, particularly private consumption, will remain the engine of growth for most countries. Despite the stabilization or depreciation of most of the region's major currencies since early or mid-2015, exports continued to decline in early 2016, particularly in relation to intraregional trade. Investment remains generally weak, although Malaysia and Viet Nam, which are expected to reap significant benefits from the Trans-Pacific Partnership, are projected to step up investment in preparation for the trade agreement. The establishment of the Association of Southeast Asian Nations (ASEAN) Economic Community at the end of 2015 and the introduction of other regional economic integration measures could also entice additional private investment. Inflation has been subdued across the region, with some economies facing deflationary pressure. For the region as a whole, GDP growth is projected to average 5.5 per cent in 2016 and 5.6 per cent in 2017. China is projected to grow by 6.4 per cent in 2016 and 6.5 per cent in 2017, in line with the Government target. China's import demand, particularly for commodities, is unlikely to rebound strongly during the forecast period, given the policy focus on addressing industrial overcapacity and excessive housing inventory. This will continue to weigh on global commodity prices. A more substantial slowdown in the Chinese economy remains a downside risk both for the region and on a global scale.

23. Across the region, fiscal policy is expected to play a more prominent role in boosting growth, although there are concerns regarding striking the balance between fiscal discipline and flexibility in several countries. Despite the already low interest rates, room for further monetary loosening also exists for many economies. However, this may entail risks in relation to capital outflow and the rising level of household and corporate leverage.

24. Despite the protracted instabilities and general weakness of the global economy, the economic outlook for South Asia remains favourable, with most countries benefiting from low oil prices. Regional GDP growth is expected to accelerate from 6.1 per cent in 2015 to 6.6 and 6.8 per cent in 2016 and 2017, respectively, owing to robust private consumption, strengthening investment demand and gradual progress on domestic policy reforms. Inflation is projected to remain relatively tame, reflecting subdued commodity prices and lower pressures from supply-side bottlenecks. This has increased monetary policy space, with prospects for further easing in some economies, including India. In contrast, fiscal policies remain tight or under consolidation in most countries, and deficits will remain relatively high, particularly in Bangladesh, Pakistan and Sri Lanka. Overall, the positive outlook will enable further gradual progress on poverty reduction.

25. The regional prospects are contingent on robust growth in India and the recovery of the Islamic Republic of Iran. The economy of India is slowly gaining momentum, with an expected GDP growth of 7.3 and 7.5 per cent in 2016 and 2017, respectively. Despite some delays in domestic policy reforms and enduring fragilities in the banking system, investment demand is supported by the monetary easing cycle, rising FDI, and government efforts towards infrastructure investments and public-private partnerships. Meanwhile, after several years of economic difficulties, the outlook for the Islamic Republic of Iran is improving as the lifting of international sanctions encourages the revival of the oil sector and facilitates trade and financial flows. In contrast with the regional trend, the outlook in Sri Lanka has deteriorated, amid a weak fiscal position and balance-of-payments difficulties.

26. Notwithstanding the favourable outlook, South Asian economies face several domestic downside risks, including setbacks in reform agendas and political instabilities. Structural issues such as energy shortages, low participation of women in the labour force and large infrastructure gaps remain major regional challenges.

27. The economic outlook for Western Asia continues to be driven by oil market developments, ongoing conflicts and geopolitical concerns. Regional GDP growth is expected to weaken further, from 2.8 per cent in 2015 to 2.4 per cent in 2016, as lower oil prices require significant macroeconomic adjustments and investment demand remains subdued. Against this backdrop, inflation is projected to continue on a relatively moderate path in most economies, while weak labour markets are not expected to improve substantially, with structural unemployment remaining high, particularly among young people.

28. The slowdown is more pronounced in the countries of the Cooperation Council for the Arab States of the Gulf, with domestic demand decelerating and external and fiscal accounts weakening in most economies. Even though several countries benefit from large international reserves and sovereign wealth funds, particularly Kuwait, Qatar and the United Arab Emirates, all Gulf Cooperation Council countries are undertaking major reforms in order to maintain fiscal sustainability, including

spending and subsidy cuts, tax increases and, progressively, new issuance of external debt. In addition, Gulf Cooperation Council countries lifted their policy rates following the Federal Reserve's increase in December 2015. Against this backdrop, the outlook for Gulf Cooperation Council countries has visibly worsened since the end of 2015, especially in Bahrain, Oman and Saudi Arabia. As a result, they need to strike a delicate balance among subsidy reforms, tax increases and new debt issuance in order to secure social cohesion, fiscal sustainability and growth prospects.

29. Among the more diversified economies, the economy of Turkey will receive a boost in consumption from a large rise in the minimum wage in 2016, but economic activity will be constrained by weak investment, political uncertainty and a tightening policy stance. In countries experiencing military conflicts and geopolitical turmoil, such as Iraq, the Syrian Arab Republic and Yemen, the humanitarian crisis continues and economic and social conditions remain precarious. The expansion of armed conflicts and geopolitical tensions is a serious downside risk for the region.

Africa

30. Economic growth in Africa continues to lose momentum, as it is buffeted by global, regional and internal headwinds. While many countries have embarked on a gradual process of economic diversification, with investment increasingly directed towards the manufacturing sector, the continent remains highly commodity-dependent. Given the low level of global commodity prices, export income in many countries dropped sharply in 2015 and may fall further in 2016. Many countries suffer from continued shortfalls in infrastructure such as energy supply and health-care facilities, leading to power shortages in countries such as Nigeria and South Africa and complicating progress towards economic and social development. In addition, many parts of the continent have suffered from severe drought, which has decimated crops and livestock and severely curtailed agricultural production in the affected regions. This has pushed up inflation, required higher imports of food staples, further reduced export earnings and put pressure on public finances, as basic foodstuffs are widely subsidized. Security concerns also continue to weigh on many parts of the continent, undermining confidence and economic activity.

31. GDP growth for the continent as a whole slowed to 3.0 per cent in 2015, and a further moderation, to 2.8 per cent, is expected in 2016. This marks a significant downward revision to forecasts reported in *World Economic Situation and Prospects 2016*. While a modest recovery, to 3.4 per cent, is expected in 2017, growth in Africa will remain well below the average of nearly 6 per cent per annum seen in the years leading up to the global financial crisis. When viewed in per capita terms, the outlook is particularly bleak, with GDP per capita growth expected to average just 0.4 per cent from 2015 to 2017.

32. The ongoing political turmoil in Libya has pushed the oil-reliant economy into a prolonged and deep recession, which continues to restrain growth and adversely affect political and economic governance in North Africa. Security concerns remain elevated across much of the region, with a severe impact on the tourism sectors of Egypt and Tunisia in particular, although some improvements are emerging. Security issues are becoming increasingly widespread across other African regions as well, dampening confidence across parts of Central, East and West Africa.

33. The downward revision to economic prospects in Southern Africa reflects the deterioration of commodity prices, the severe drought wrought by El Niño and inflationary pressures from widespread currency depreciation. Severe drought has also swept across Ethiopia and parts of Somalia in East Africa, while parts of North Africa have suffered from drought conditions.

34. In West Africa, economic growth in the small economies of Guinea, Liberia and Sierra Leone is expected to bounce back noticeably in 2016 after the Ebola epidemic. However, the region's larger economies continue to face difficulties posed by low commodity prices. Central Africa is dominated by heavily oil-reliant economies, which can be expected to suffer further export losses in 2016.

35. With inflationary and currency pressures rising across much of Africa, central banks in Angola, Egypt, the Gambia, Ghana, Kenya, Malawi, Mozambique, Namibia, Nigeria, South Africa and Zambia have increased their policy rates in recent months. This is in contrast to the moves in Botswana, Cabo Verde, Morocco, Tunisia and the currency unions of Central and West Africa, which have been more closely aligned with monetary policy in the euro area. This widening divergence of rates of return within Africa can be expected to drive shifts in capital flows and further currency pressures in the region in 2016.

36. Governments require new sources of revenue to respond to mounting fiscal pressures from weak growth, lost commodity-related revenue and rising expenditure to combat weather-related crises. Several African countries have issued dollar-denominated debt since the global financial crisis. While this has allowed them to borrow at much lower interest rates, it has also exposed them to currency risk. These risks have materialized in countries such as Angola, Ghana, Namibia, the United Republic of Tanzania and Zambia, where currencies have lost up to 50 per cent of their value since 2014, doubling debt-servicing costs on foreign currency-denominated debt.

Latin America and the Caribbean

37. The economic prospects for Latin America and the Caribbean deteriorated notably over the past six months as the region felt the impact of lower commodity prices, significant capital outflows and, in some cases, tighter monetary and fiscal policies. GDP growth forecasts have generally been revised downwards, especially for the commodity-dependent economies of South America, with Brazil being mired in a deeper-than-expected recession. Aggregate regional GDP contracted by an estimated 0.6 per cent in 2015 and is projected to decline at the same rate in 2016. This would mark the first time since the debt crisis in 1982-1983 that regional output has fallen for two consecutive years. In 2017, growth is expected to resume, with aggregate GDP projected to expand by 1.5 per cent on the back of a mild recovery in commodity prices and a pickup in domestic demand across the region. Medium-term growth is, however, likely to remain tepid, potentially making it harder to maintain the pace of social progress reached in the region in the 2000s.

38. Economic activity in South America is projected to contract substantially for a second year in a row as strong headwinds persist and significant macroeconomic adjustment processes are under way. The marked downgrade for the region reflects two main factors. First, Brazil is headed for a deeper and longer-lasting recession than previously expected. After GDP declined by 3.8 per cent in 2015, a further contraction of 3.4 per cent is projected for 2016. The combination of a deepening

political crisis, rising inflation, a surging fiscal deficit and high interest rates has led to a sharp deterioration of consumer and business confidence, which remains close to historical lows. Gross fixed capital formation plummeted as companies aggressively slashed capital spending amid expectations of further shrinking demand and rising borrowing costs. At the same time, household consumption is being held back by rising unemployment, falling real wages and high debt levels. Against this backdrop, only a very modest recovery by 0.2 per cent is forecast for 2017, contingent upon an easing of the political crisis and a stabilization of the macroeconomic situation. Given the significant trade and financial linkages, the crisis in Brazil has negative spillover effects on several neighbouring countries, most notably Argentina, Bolivia (Plurinational State of) and Paraguay.

39. The second factor weighing on the near-term outlook for South America is a tighter macroeconomic policy stance in most countries. Governments have started to implement fiscal consolidation measures to cope with the shortfall in revenues caused by the sharp decline in commodity prices and weaker growth. The new Government of Argentina, for example, cut electricity subsidies, while the Government of Colombia decided to reduce investment spending in 2016. At the same time, almost all central banks have tightened monetary policy in response to rising inflation, which has been fuelled by the large depreciations of national currencies during the past two years. In several countries (Colombia and Paraguay, for example), inflation has also been pushed up by higher food prices caused by droughts or flooding related to El Niño. Consumer price inflation is currently well above the target levels of most central banks, exceeding 10 per cent in Argentina, Brazil, Uruguay and Venezuela (Bolivarian Republic of). While higher policy rates have eased some pressure on capital flows and currencies, the tight fiscal and monetary stance will weigh on domestic demand and could exacerbate the cyclical downturn.

40. In contrast to South America, the prospects for Mexico, Central America and the Caribbean have worsened only slightly over the past six months. The Mexican economy is expected to see stable but subdued growth in 2016, held back by lower oil and gas production and a tight fiscal budget. The prospects for Central America and the Caribbean are generally more benign. Most countries are expected to benefit from lower oil prices, solid growth in the United States and relatively supportive macroeconomic policies, but growth performances will continue to vary considerably.

Least developed countries

41. GDP growth in the least developed countries is forecast to reach just 4.8 per cent in 2016 and 5.5 per cent in 2017, well below potential and well below the Sustainable Development Goal target of at least 7 per cent GDP growth. There is a risk that many least developed countries, particularly those that rely largely on commodity exports, may be unable to sustain the much-needed public spending on education, health and climate change adaptation and that progress in poverty reduction may stall. Poverty reduction also risks setbacks from the economic consequences of the current El Niño cycle. In the aftermath of the strong El Niño in 1997-1998, poverty rates increased by 15 per cent in some affected countries, as losses in the agricultural sector and high food prices tend to have a disproportionately large impact on the poor. Further poverty reduction efforts will

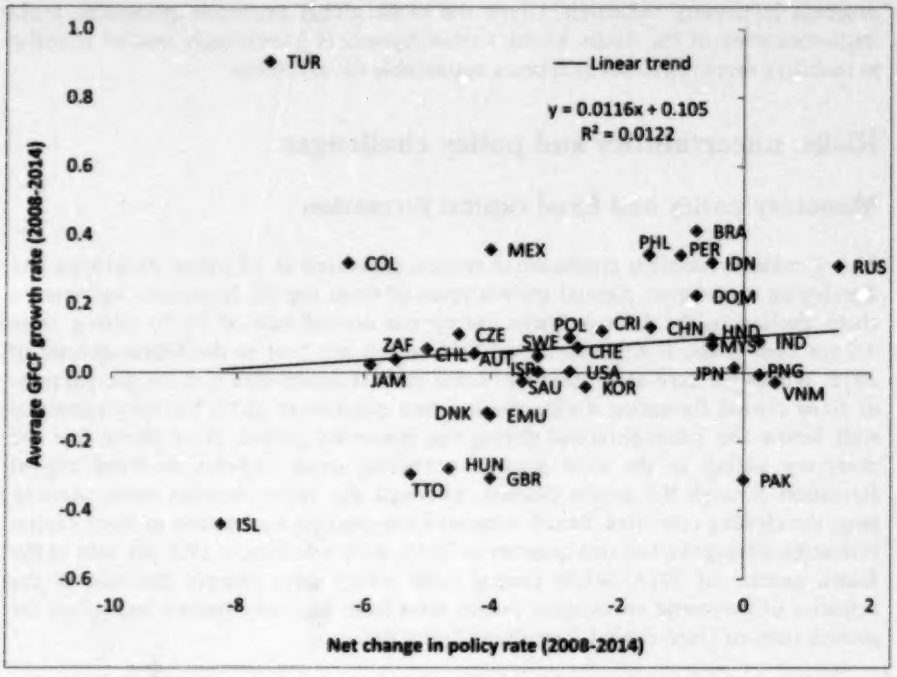
need to be supported with adequate and effective redistribution policies, while concerted policy efforts at both the national and global levels are needed to ensure that the damage wrought by shocks such as El Niño do not derail or reverse the progress in poverty reduction. Given the bleak global economic prospects, rapid implementation of the Addis Ababa Action Agenda is increasingly crucial in order to mobilize more resources to finance sustainable development.

III. Risks, uncertainties and policy challenges

Monetary policy and fixed capital formation

42. Capital investment continues to remain depressed in all major developed and developing economies. Annual growth rates of fixed capital formation registered a sharp decline in the United States during the second half of 2015, falling from 4.6 per cent in the fourth quarter of 2014 to 3.0 per cent in the fourth quarter of 2015. Within the euro area, there was some modest improvement in the growth rates of fixed capital formation during the last two quarters of 2015, but they remained well below the rates observed during the pre-crisis period. It is likely that the monetary easing in the euro area is providing some impetus to fixed capital formation through the credit channel, although the effect remains weak. Among large developing countries, Brazil witnessed the sharpest contraction in fixed capital formation during the last two quarters of 2015, with a decline of 18.5 per cent in the fourth quarter of 2015. While central bank policy rates sharply declined in the majority of the world economies, policy rates have had only limited impact on the growth rates of fixed capital formation (figure III).

Figure III
Changes in policy rates and average growth rates of fixed capital formation in selected economies



Abbreviations: AUT, Austria; BRA, Brazil; CHE, Switzerland; CHL, Chile; CHN, China; COL, Colombia; CRI, Costa Rica; CZE, Czech Republic; DNK, Denmark; DOM, Dominican Republic; EMU, euro area; GBR, United Kingdom of Great Britain and Northern Ireland; GFCF, gross fixed capital formation; HND, Honduras; HUN, Hungary; IDN, Indonesia; IND, India; ISL, Iceland; ISR, Israel; JAM, Jamaica; JPN, Japan; KOR, Republic of Korea; MEX, Mexico; MYS, Malaysia; PAK, Pakistan; PER, Peru; PHL, Philippines; PNG, Papua New Guinea; POL, Poland; RUS, Russian Federation; SAU, Saudi Arabia; SWE, Sweden; TTO, Trinidad and Tobago; TUR, Turkey; USA, United States of America; VNM, Viet Nam; ZAF, South Africa.

43. The unconventional monetary policy measures pursued by the major central banks since the onset of the global financial crisis managed to ease liquidity constraints in the financial system, boost asset prices and restore the balance sheets of corporates and households. There is, however, little evidence that the quantitative easing measures boosted credit growth and investment rates, largely because of their limited pass-through effects on lending rates. As shown by Illes and Lombardi (2013),[6] while central bank policy rates have been record low in most developed economies, the low policy rates have not necessarily resulted in significantly lower lending rates for households and the non-financial corporate sector. In fact, the effect on real interest rates has been more muted, and in a number of countries, decreases in policy rates have been associated with increases in real interest rates, largely because of sharper downward adjustments in inflation (table 2). Weak

[6] Anamaria Illes and Marco Lombardi, "Interest rate pass-through since the financial crisis", Bank for International Settlements, *BIS Quarterly Review* (September 2013).

monetary transmission channels on the supply side and persistent uncertainty on the demand side largely explain why monetary easing did not lead to higher levels of borrowing and capital formation by the non-financial sector.

Table 2
Changes in policy rates and lending rates in selected economies, 2008 to 2014

	Net change in policy rates	*Net change in lending interest rate*	*Net change in real interest rate*
	2008-2014	*2008-2014*	*2008-2014*
United States	-2.75	-1.8	-1.3
Japan	-0.15	-0.7	-3.6
United Kingdom of Great Britain and Northern Ireland	-4.00	-4.2	-3.0
Canada	-3.75	-1.7	0.4
Australia	-4.25	-3.0	0.3
China	-1.47	0.3	7.0
India	0.25	-3.0	2.7
Brazil	-0.75	-15.2	-11.8
Russian Federation	1.5	-1.1	8.5
South Africa	-5.50	-6	-2.6

Source: Central bank policy statements and World Development Indicators.

44. *World Economic Situation and Prospects 2016* highlighted the linkages between falling fixed capital formation and diminishing productivity trends during the post-crisis period. While productivity growth had begun falling before the global financial crisis, particularly in the United States, the downturn in productivity growth became more pronounced with the near collapse of fixed investment that began in 2009. Falling investment and productivity growth has had an adverse impact on the trajectory of potential growth in both developed and developing economies. If weak investment trends worldwide continue to persist, it is unlikely that productivity growth will accelerate in the near term, and the promise of decent work and higher living standards, as envisaged in the 2030 Agenda for Sustainable Development, will remain elusive. Monetary easing measures need to be complemented with targeted lending programmes, especially for small and medium-sized enterprises, to ensure that low policy rates indeed boost borrowing, investment and productivity growth. There also need to be complementary fiscal measures, as discussed in the following section, for the stimulation of investment and growth and the realization of the 2030 Agenda for Sustainable Development.

Expanding and exploiting fiscal space

45. The latest round of downward revisions to growth forecasts reinforces the concern that the world economy remains stuck in a low-growth equilibrium that could impede progress towards the achievement of the Sustainable Development Goals. Since 2010, the developed countries, as well as some emerging market economies, have relied primarily on monetary policy to stimulate growth and job

creation. This heavily skewed macroeconomic policy mix has failed to revive investment and productivity, leaving a significant scar on medium-term economic prospects. Against this backdrop, *World Economic Situation and Prospects 2016* recommended a fundamental shift towards a more balanced macroeconomic policy mix in major countries, including a more supportive role for fiscal policy. The case for fiscal expansion is supported both by the limited gains and potential downside risks associated with a further expansion of unconventional monetary policy measures and by the argument that fiscal multipliers are particularly large under current conditions (namely, where the monetary stance is highly accommodative). Several recent studies have documented that expansionary fiscal policy, particularly increases in government investment, can have unusually strong effects when policy rates are close to zero.[7]

46. In order to adopt an expansionary fiscal stance, Governments must have some degree of "fiscal space", although there is no consensus on how this should be defined or measured. The most widely used definition describes it as the availability of budgetary room that allows a government to provide financial resources for a specific activity without affecting its financial sustainability.[8] The notion of fiscal space is thus closely linked to the concept of debt sustainability.

47. A measure of fiscal space now increasingly adopted is the distance between a country's current public debt level and an estimated debt limit that depends on its country-specific history of fiscal adjustment and the interest rate it faces.[9] Using this metric, a considerable majority of economies appear to have more limited fiscal space than at the onset of the global financial crisis. In a sample of 122 developed and developing countries, over 75 per cent saw an increase in the gross public debt-to-GDP ratio between 2008 and 2014. Europe and North America had the most rapid rise, with significant rises in many countries in Africa, CIS, Latin America and the Caribbean, and Western Asia as well. Preliminary data for 2015 indicate that the upward trend continued, especially in developing economies. The broad-based increase in the public debt-to-GDP ratios can be attributed to financial sector bailouts and large fiscal stimulus programmes in the aftermath of the crisis, but also the protracted period of subdued GDP growth in most parts of the world economy. In many developing countries, particularly in Africa, Latin America and the Caribbean, and Western Asia, it also reflects the sharp decline in commodity prices and currency depreciation among economies with high foreign currency-denominated debt.

48. While fiscal space is generally more restricted than in 2008/09, current debt levels are still well below the estimated debt limits reported by Ghosh and others[9] in most countries, suggesting that fiscal space may still be available in many economies. This is further substantiated by the benign conditions for government borrowing that currently prevail, especially in developed economies. Government borrowing costs are currently close to historic lows in many countries. According to recent estimates, about $8 trillion in government bonds globally have negative yields, including one third of euro area bonds and three quarters of Japanese government bonds. More importantly, while yields are expected to increase from

[7] See, for example, Ethan Ilzetzki, Enrique G. Mendoza and Carlos A. Végh, "How big (small?) are fiscal multipliers?", *Journal of Monetary Economics*, vol. 60, issue No. 2.

[8] Peter S. Heller, "Understanding fiscal space", International Monetary Fund (IMF) Policy Discussion Paper, No. 05/4.

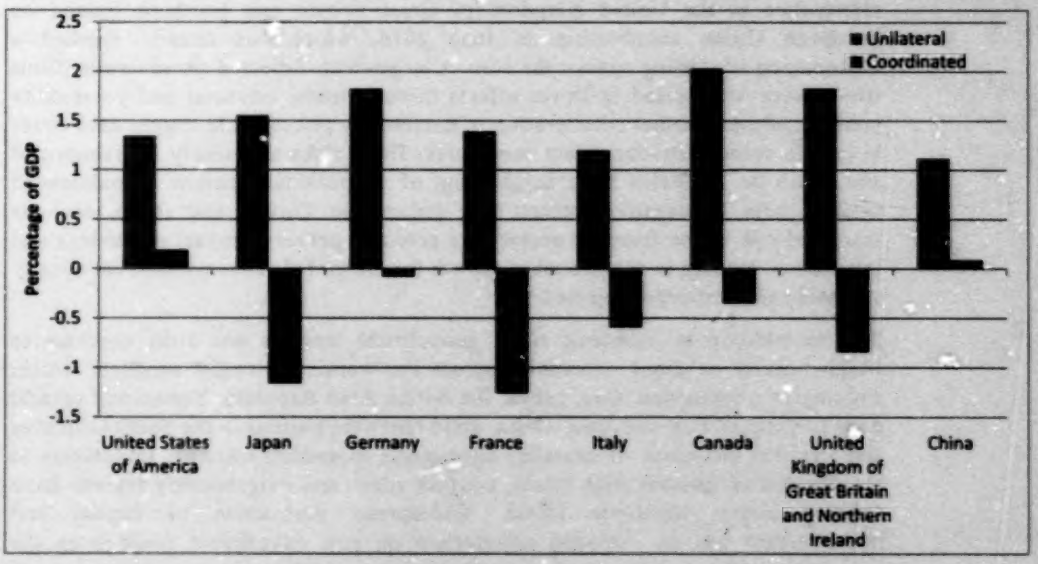
[9] See, for example, Atish R. Ghosh and others, "Fiscal fatigue, fiscal space and debt sustainability in advanced economies", *The Economic Journal*, vol. 123, issue No. 566.

their ultra-low levels in the next few years, they are expected to remain low for an extended period. Barring a sudden rise in borrowing costs, the compound interest of any newly incurred debt will accumulate at a minimal rate. In the developing countries, the medium-term outlook for borrowing costs is more uncertain and there is a greater risk that financing costs could rise more rapidly.

49. A reorientation towards a more balanced policy mix would exploit fiscal support along three routes. First, countries that have sufficient fiscal space and face low borrowing costs should raise fiscal expenditures, in particular by expanding public investment in infrastructure, research and development and other areas that can lift potential growth. From a global perspective, the most effective strategy would be a coordinated fiscal stimulus by a group of large developed and emerging economies, similar to the Group of 20 (G-20) agreement on coordinated stimulus measures in 2009. This would ensure that a maximum number of countries in all regions benefit from the positive spillover effects, thus helping to raise the global multiplier. In a simulation exercise, an increase in fiscal expenditures of 1 per cent of GDP in the Group of Seven (G-7) countries and China could raise world gross product growth from 2.4 to 3.8 per cent in 2016. The spillovers to developing countries would be significant, allowing growth in the least developed countries to reach 5.7 per cent, compared with a baseline projection of 4.8 per cent. Compared with a stimulus that is introduced unilaterally in a single country, a coordinated stimulus would, for the most part, offset the costs of the expansion, owing to the global spillovers of growth between countries (figure IV). If the fiscal spending were directed towards capacity-raising investment, the net impact on government debt would be even smaller.

Figure IV

Rise in government debt after 10 years under unilateral and coordinated fiscal expansions



Source: World Economic Forecasting Model simulations.

Note: An expansion of government spending by 1 per cent of GDP in year one is gradually withdrawn over the next 10 years. The unilateral scenarios are conducted in one country at a time, while the coordinated scenario is conducted for all eight countries simultaneously.

50. Second, even where fiscal space is limited, there is ample room for Governments in both developed and developing countries to enhance the medium-term impact on growth and employment generation by improving the efficiency of fiscal measures. This could encompass a partial reallocation of public expenditures from consumption to investment, as well as a range of structural reforms aimed at strengthening employment and productivity.

51. Third, Governments in developing and transition economies should aim to gradually expand fiscal space by increasing revenues. This would allow increased investment in infrastructure, health, education and environmental protection measures, without incurring further debt. In many parts of Africa, South Asia and Western Asia, tax-to-GDP ratios are very low, mostly less than 15 per cent, compared with an average rate of 34 per cent in developed countries. Broadening the tax base, strengthening tax administration and increasing compliance can help to create additional fiscal space for countercyclical policies and increased development spending.

52. The reorientation of the policy mix should be part of a broader medium-term fiscal sustainability framework that will eventually bring the public debt burden down to more sustainable levels.

Risks and uncertainties

53. Downside risks to the global economy remain elevated. Key areas of concern include deepening financial vulnerabilities in a number of developing countries, which could be sharply exacerbated by a sudden withdrawal of capital. Financial vulnerabilities in developed economies could also intensify following the referendum in the United Kingdom of Great Britain and Northern Ireland on European Union membership in June 2016, which has already sparked a depreciation of sterling against the euro. A larger-than-expected slowdown in China would have widespread spillover effects through trade, financial and commodity markets, while a further deterioration of commodity prices could trigger debt crises in certain commodity-dependent economies. These risks are closely interconnected and could be amplified by a heightening of geopolitical tensions or unintended consequences of negative interest rate policies in Europe and Japan, such as increased risk in the financial sector or a potential perverse impact on savings and investment, leading to much weaker growth for the global economy than the already subdued pace currently projected.

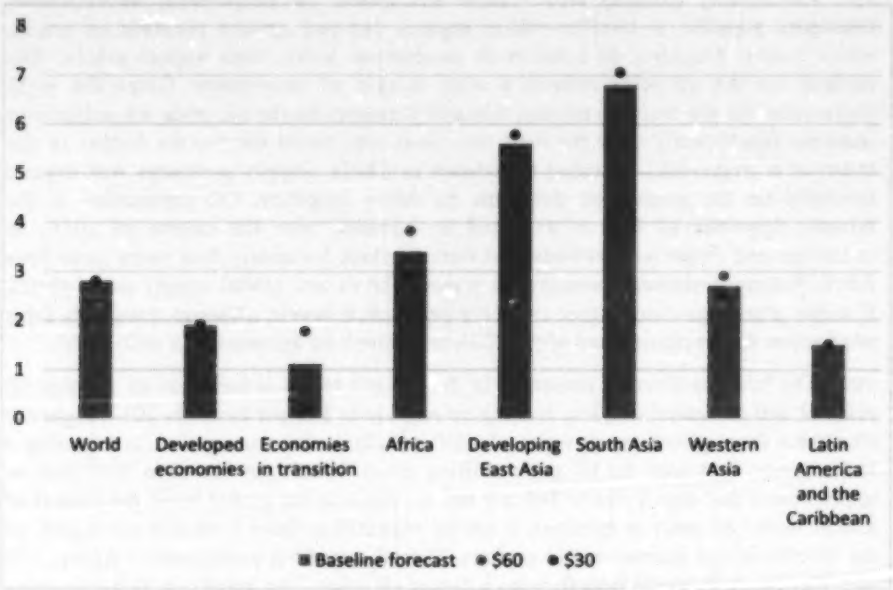
54. In addition to economic risks, geopolitical tensions and risks continue to weigh heavily on many economies across the world. Prolonged conflicts remain ongoing in Afghanistan, Iraq, Libya, the Syrian Arab Republic, Yemen and several parts of Central, East and West Africa, amid renewed tensions in the South Caucasus and frequent violations of ceasefire agreements in eastern Ukraine. In addition to the devastating humanitarian crises, conflict zones and neighbouring regions have suffered heavy economic losses. Widespread destruction of capital and infrastructure and an extended moratorium on new investment could keep the economies well below pre-conflict production potential for many years, even once a lasting solution is in sight. Millions of people are being displaced from their homes, driving the most severe refugee crisis since World War II. Trade flows are suffering from the higher costs of transportation and insurance, while a general loss of

confidence continues to discourage both domestic and foreign investment and tourism flows in conflict-affected countries.

55. Commodity markets also remain susceptible to geopolitical uncertainties. Disrupted supplies in conflict-ridden regions can put upward pressure on prices, while policy decisions in relation to production levels also impact prices. The outlook for the oil price reflects a wide margin of uncertainty. Given the weak projections for the world economy, demand pressures on the oil price are unlikely to increase significantly over the next two years and could deteriorate further in the event of a larger-than-expected slowdown in China. Supply pressures will depend crucially on the production decisions of major suppliers. Oil production in the Islamic Republic of Iran is expected to increase over the course of 2016, as economic and financial sanctions that were in place for nearly four years have been lifted, putting downward pressure on prices. The excess global supply could shrink if major producers could agree to freeze production levels, although prospects for a production freeze diminished after a failure to reach an agreement in mid-April.

56. The baseline forecast presented in the present report is based on an average oil price of $40 per barrel in 2016, inching up slightly to $46 per barrel in 2017. Figure V illustrates the regional sensitivities of GDP growth to this assumption, considering a lower bound that sees the oil price drifting down to $30 per barrel in 2017 and an upper bound that sees a rise to $60 per barrel. While at the global level, the impact of a shift in the oil price is minimal, it can be expected to have a significant impact on the distribution of income across regions. The oil-exporting economies of Africa, CIS and Western Asia would benefit from a higher oil price. The impact on fuel-importing economies would be more modest and would be most evident in inflation. A lower oil price would increase deflationary pressures and could lead to further delays in interest rate rises by the Federal Reserve. Additional risks associated with a further deterioration in commodity prices include the increase of fiscal pressures in commodity-exporting countries, which could eventually call into question the sustainability of government debt in certain countries.

Figure V
Gross domestic product growth projections for 2017 under different oil price assumptions



Source: Department of Economic and Social Affairs, World Economic Forecasting Model simulations.